

TECHNICAL COOPERATION DOCUMENT

BAHAMAS

I. BASIC INFORMATION

Country:	The Bahamas		
TC name:	Conditions for a sustainable fiscal policy in The Bahamas		
TC number:	BH-T1022		
Team members:	Gerardo Reyes-Tagle (ICF/FMM), Project Team Leader; Alma Romero (ICF/FMM); Bernardita Saez Rozas (LEG/LEG); Valerie Mercer-Blackman (CCB/CCB); Michael Nelson (CCB/CCB); Cherran O'Brien (CCB/CBH).		
Operation type:	Client Support		
Government request:	December 7, 2010		
TC profile date:	November 1 st , 2011		
Beneficiary:	Ministry of Finance (MoF)		
Executing agency:	IDB		
Financing:	IDB (Japanese Special Fund):		US\$612,000
	Local:		<u>US\$153,000</u>
	Total:		US\$765,000
Date of TC startup:	December 1st 2011		
Execution period:	24 months	Disbursement period:	30 months
Bank technical unit:	ICF/FMM	Disbursement unit:	CBH
Consultancy types:	Firm and individual		
TC included in CS or CPD	Yes [X]	GCI-9 priority:	Yes [X]
	No []		No []

II. OBJECTIVES AND JUSTIFICATION

A. Macroeconomic Performance

- 2.1 Over the last two decades, the Bahamas had good economic performance together with high per capita income levels, resulting from sound economic management, political stability and proximity to the United States of America (USA). Over that period, the country's annual economic growth has averaged about 1.3% with a strong growth spurt of about 5% during 1993-99.
- 2.2 The 2008/09 USA recession, however, affected negatively the Bahamian economy—the overall economy contracted by 5.4% in 2009, and sectors critical to the tax base contracted even more. For example, during 2009, both hotel room expenditures and merchandise imports dropped by about 21% each, undermining tax revenues and collection. This negative impact on revenues, combined with increased expenditures, caused the overall fiscal deficit to reach 4.4% of GDP, to finance this deficit, public debt stock grew sharply. Thus, in 2010, central government debt represented about 48% of GDP, rising sharply from 29% of

GDP at the end of 2005. Public sector entities held much of public debt, and so the consolidated public debt represented about 55% of GDP.

- 2.3 Structurally, the worsening of the fiscal balance is, primarily due to:
- a. The tax base is narrow and volatile. Import taxes are by far the most important source of government revenues, accounting for close to 45% of revenues,¹ followed by stamp taxes (15% of revenues), tourism taxes (8% of revenues), business licenses and immigration fees (7% of revenues). Property taxes, applied for the most part on high valued non-resident property add another 6%, and a variety of other of tax, non-tax items and grants account for the remaining 20% of government revenues. As a result of the high proportion of trade and tourism-based taxes, revenues are highly procyclical.
 - b. Tax administration capacity is weak. This is particularly so for domestic or inland revenues. Part of this weakness is due to the current tax structure. Customs Department collects taxes on international trade and excises, while the administration of the inland or domestic revenues is dispersed across some 30 ministries, departments and agencies. This structure is a series of unrelated transactional taxes, fees and service charges. Many of these taxes and fees are directly related to the particular government program that collects the fees or service charges, such as motor vehicle licenses.
- 2.4 The Bahamas is currently collecting about 1% of GDP from the annual Real Property Tax despite taxing a narrow tax base, full of exemptions, with low and out of date property valuations, and a very low collection rate—estimated to be about 50% with virtually no enforcement against non-compliance. It is estimated that the annual property tax revenue could be increased to about 2% of GDP in the next 5 years. This could be achieved through implementing administrative reforms that more effectively capture the tax base, gradually reducing the number of exemptions, updating the valuations, improving the collecting rate and adopting and implementing effective sanctions and penalties to deal with noncompliance.

B. Fiscal sector background

- 2.5 To make tax administration more efficient and boost revenues, the Government of The Bahamas (GoBH) is developing a central revenue administration based on international best practices. When fully implemented, the new tax administration will feature an efficient function-based structure and it will be responsible for administering a broad range of existing taxes. A new planning and monitoring unit within the administration will be responsible for strategic and operational planning, as well as performance monitoring and improvement. The new tax administration structure is being implemented in two phases. In Phase I, a Tax Administration Division (TAD) will be established within the Ministry of Finance (MoF), with responsibility for the collection of specific taxes and fees, and with broad responsibilities for planning and compliance for revenues across government. When these changes are implemented, Customs will be responsible

¹ The Bahamas has no income tax and no broad-based tax on sales.

for collection of some 56% of total taxes, fees and service charges, and the TAD for a further 31%, bringing the direct involvement of the MoF to about 87% of the total. Phase II to be implemented in the medium to longer-term, will establish a more autonomous tax administration organization structured along functional lines, i.e. registration, taxpayer services and education, returns and payment, arrears management, audit, and appeals.

- 2.6 Debt management has the following weaknesses: i) limited development of the domestic market; ii) the authorities in charge of debt management are unable to minimize debt service cost due to a lack of a debt strategy and use of diversified portfolio instruments; iii) poor coordination among institutions in charge of debt management; iv) a debt management unit has not been established; and v) the MoF is unable to provide timely information to the stakeholders on debt, generating decision making problems to them.
- 2.7 The urgency of the fiscal challenge in The Bahamas has been identified in the 2011 Operational Program Report (GN-2617): “Given the rapid escalation of the debt profile, the GoBH priorities may change as greater fiscal effort is required to meet interest payments.” The debt-to-GDP ratio has risen from 32% in 2007 to nearly 50% in 2011, mostly the result of a falloff of tax revenues, which in turn were badly hit by lower economic activity. Moreover, current expenditures, particularly transfers to other governmental entities and public corporations, rose by almost 2% of GDP in the same period. In the 2011/12 budget, the freeze on wages and salaries has been lifted, so this component is expected to increase as well.
- 2.8 The overall objective of the technical cooperation is to provide policy options to the GoBH that support fiscal sustainability in the short and medium term. This will be done by strengthening the capacity of the tax administration and debt management areas. In particular, the TC will help strengthen the property tax administration system to collect such taxes in a more efficient way, and will help the government handle fiscal risks and debt portfolio management more effectively.

III. DESCRIPTION OF ACTIVITIES

- 3.1 **Component I. Tax administration strengthening.** This component will finance: (i) training programs for strengthening the institutional capacity of the new TAD; (ii) a diagnostic of the Stamp Tax Act, the Hotels Act and the legislation dealing with bank and trust licenses, and insurance; and (iii) an analysis of the impact of the new institutional structure in the tax administration system.
- 3.2 **Component II. Property tax system.** This component will finance the design and implementation of a multi-year comprehensive action plan for strengthening the property tax administration system, including: (i) a redrafting proposal for the Real Property Tax Act, to modernize it and make it more flexible to accommodate reforms; (ii) a new tax administration information system, to allow for better monitoring and management of the tax registry, property valuations, tax billing, and taxpayer account management; (iii) a complete and up-to-date property tax

registry mechanism to improve the accuracy of taxpayer identification and property ownership; (iv) a comprehensive valuation of all registered property, and improved procedures and mechanisms for property revaluation; (iv) improved procedures for tax collection, enforcement and management of arrears; and (v) enhancement of taxpayer service, awareness and education.

- 3.3 **Component III. Quality of expenditure.** This component will finance an in-depth analysis of the costs to the government of providing services in the Family Islands. For that purpose, the analysis will REVIEW at the expenditure structure by sector and geographic distribution.
- 3.4 **Component IV. Fiscal risks.** This component will finance an assessment of fiscal risks in health and pensions and capacity building in better handling contingent liabilities on pension funds and public enterprises.
- 3.5 **Component V. Debt strategy and management.** This component will finance the design and implementation of a multi-year debt strategy program. It aims at strengthening the institutional capacity of the Debt Management Unit and the Central Bank to generate an effective portfolio strategy to better handle the debt stock, profile and flow.
- 3.6 At the end of the execution of the technical cooperation, the following results are expected:

Indicative Results Matrix

Indicator	Unit of Measure	Baseline		Target		Source / means of verification
		Value	Year	Value	Year	
Main outcomes						
Outcome 1. The tax gap for property tax declines						
Potential revenue minus actual revenue divided by potential revenue	%	45%	2011/12	30%	2013/14	Property Tax Department reports
Outcome 2. Level of debt growth rate declines						
Moving average of the level of debt growth	%	7%	2010/11	2%	2012/13	Central Bank statistical report
Main outputs						
Product 1. Tax administration training programs implemented (e.g. risk assessment; auditing and internal audit covering all tax administration and customs functions).	Employees	0	2011	20	2013	Tax Administration Division reports
Product 2. Redesign of the property tax registry / valuation / collection system and integration of property tax system with tax administration system designed and implemented	Reports	0	2011	4	2013	Property Tax Department reports on valuation and tax property revenues
Product 3. Training	Employees	0	2011	30	2013	Property Tax

programs on valuation of properties, tax registry, auditing and collection enforcement implemented						Department reports
Product 4. Training workshop on medium term debt strategy for MoF and Central Bank implemented (identifying objectives and scope for debt management, understanding the current debt portfolio, cost and risk characteristics of the portfolio, determining the baseline macroeconomic assumptions)	Employees	0	2011	26	2013	MoF and Central Bank report
Product 5. Integrated medium term strategy methodology between the Central Bank and MoF designed and implemented	Reports	0	2011	2	2013	Central Bank and MoF reports

IV. BUDGET

4.1 The technical assistance costs by component are indicated in table 1 below.

Components	IDB Fund	Local Counterpart	Total
Tax administration strengthening	55,000	28,000	83,000
Property tax system	382,000	50,000	432,000
Quality of expenditure	40,000	17,000	57,000
Fiscal risks	50,000	10,000	60,000
Debt strategy and management	55,000	45,000	100,000
Monitoring and Evaluation	30,000	3,000	33,000
Total	612,000	153,000	765,000

V. EXECUTION SCHEME

- 5.1 The Bank, through the Fiscal and Municipal Management Division (FMM) will be in charge of the execution of Components I, III, IV, and V. The MoF will be in charge of the execution of Component II, with assistance of the Bank. The execution scheme has been designed in coordination with the MoF, through the Office of Economic Planning. The MoF is currently executing other Bank TCs and thus does not have the institutional capacity to manage this operation as a whole without considerable delay on overall TC execution portfolio.
- 5.2 Notwithstanding the foregoing, and bearing in mind the limitations that exist in regards to Bank execution and the procurement of works and goods, the MoF will execute component 2 of the TC. The MoF will apply Bank policies for such procurement, and ToR will require Bank approval.

- 5.3 In terms of monitoring, the GoBH will submit to the Bank a copy of the annual operating plans for the Property Tax Division, TAD and the debt management area as well as the execution plan for the duration of the TC. The monitoring and evaluation, especially of capacity building the following activities includes:
- a. Property tax administration system strengthened through the follow up of the implementation of the action plan to be established at the beginning of the TC; i.e., the number of courses offered (and participants) in valuation, sanctions and penalties to deal with noncompliance and the new operating platform of the property tax administration system.
 - b. TAD strengthened. This will be followed up and evaluated through the capacity building programs in the new TAD.
 - c. Debt management. This will be monitored through the MTDS reports that will be generated to strengthen the MoF and the Central Bank's ability to conduct debt portfolio strategies and medium term scenarios on debt profile.

VI. RISKS AND SPECIAL ASPECTS

- 6.1 The risk for this TC lack of priority from the authorities. This is not very likely as the fiscal stress faced by The Bahamas is increasing. In addition, there is a consensus within the government and among political parties that strengthening the tax administration is a priority for the country. In addition, to mitigate this risk, the Bank is coordinating with the authorities the preparatory steps for the action plan and the schedule under the execution of the TC.

VII. ENVIRONMENTAL CLASSIFICATION

- 7.1 The results from the Safeguards Policy Filter Report and the Screening Form, classify this operation as "C" (see Annex IV), with no further mitigation actions.


CONDITION FOR A SUSTAINABLE FISCAL POLICY IN THE BAHAMAS

BH-T1022

CERTIFICATION

I hereby certify that this operation was approved for financing under the Japan Special Fund (JSF) through a communication dated on September 6, 2011 and submitted by Mr. Yasushi Kinoshita, Director-General of the International Bureau, Ministry of Finance of Japan. Also, I certify that resources from the Japan Special Fund (JSF) are available for up to US\$612,000 in order to finance the activities described and budgeted in this document. This certification reserves resources for the referenced project for a period of nine (9) calendar months counted from the date of signature below. If the project is not approved by the IDB within that period, the reserve of resources will be cancelled, except in the case a new certification is granted. The commitment and disbursement of these resources shall be made only by the Bank in U.S. dollars. The same currency shall be used to stipulate the remuneration and payments to consultants, except in the case of local consultants working in their own borrowing member country who shall have their remuneration defined and paid in the currency of such country. No resources of the Fund shall be made available to cover amounts greater than the amount certified herein above for the implementation of this operation. Amounts greater than the certified amount may arise from commitments on contracts denominated in a currency other than the Fund currency, resulting in currency exchange rate differences, for which the Fund is not at risk.

H. SUGA
11/30/11




Marguerite S. Berger
Chief
Grants and Co-financing Management Unit
VPC/GCM

11/30/2011
Date

APPROVAL

Approved:



Vicente Fretes Cibils
Division Chief
ICF/FMM

NOV 30 2011

Date